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¶1. (SBU) SUMMARY: Recent economic highlights in Ethiopia include: 1) Government of Ethiopia (GoE) claims 10 percent Gross Domestic Product (GDP) growth for fiscal year 2008/09; 2) Falling inflation rates; 3) Birr still overvalued at 12.59 per USD alongside continuing foreign exchange crunch; 4) Widening trade deficit; and 5) Electricity supply boosted by three new plants. President Girma Woldegiorgis announced Ethiopia's 10 percent GDP growth to Parliament amid doubts expressed by international economists as well as opposition party members about how Ethiopia could have attained such high growth given tough economic times locally and abroad. Annual year-on-year inflation rates have tumbled into the negative percentages--negative 3.7 percent in October 2009--in comparison to the exorbitant rates of 2008 (64 percent in July 2008). Annual average inflation is 14 percent as of October 2009. The Ethiopian Birr is trading at 12.59 per USD, but is still overvalued according to the International Monetary Fund (IMF). The foreign exchange crisis continues to plague the country as the trade deficit continues to widen and Ethiopia continues to fall short of its own export targets. Export growth was flat in 2008/09 compared to 2007/08, but imports continued to rise. Total exports were USD 1.4 billion in 2008/09 and total imports were USD 7.7 billion, creating a trade deficit of USD 6.3 billion. Finally, the power supply crisis has abated somewhat as the rainy season has ended (filling the dams). The Tekeze Hydro Electric dam officially came online in mid-November and two new hydro power plants will be online by March ¶2010. END SUMMARY.

10 Percent GDP Growth?

¶2. (U) On October 5, President Girma Woldegiorgis reported to Parliament that Ethiopia's economy grew at 10.1 percent during the 2008/09 fiscal year (ending July 7, 2009). He suggested, but stopped short of predicting, government policies would succeed in achieving the same economic feat in the upcoming year as well. Woldegiorgis stated two main GoE objectives for the 2009/10 fiscal year: 1) achieving 10 percent GDP growth rate for the seventh consecutive year; and 2) maintaining inflation rates less than 10 percent. According to the GoE, Ethiopia's average real GDP growth

was 11.5 percent during the past six years.

¶3. (U) International economists and Ethiopia's political opposition have cast doubt on the high GDP growth figures for this past fiscal year. The IMF stated publicly it believes GDP growth was approximately 7 to 8 percent in fiscal year 2008/09 and will likely be around 7 percent in 2009/10. Ken Ohashi, World Bank Country Director for Ethiopia and Sudan, argued in a locally published article Ethiopia's growth "miracle" has run into difficulties since 2008 due to high inflation and an acute shortage of foreign exchange. He noted that while inflation, which peaked at 64 percent in July 2008, has moderated, there are few signs that the shortage of foreign exchange is abating. Opposition party members also rejected President Girma's stated figures. Prominent opposition leader Merera Gudina accused the GoE of "cooking" the data. He said average Ethiopians would know the figures were false because their standard of living has failed to improve.

¶4. (SBU) Comment: GDP growth of 10 percent seems unlikely given the economic hardships Ethiopia endured this past year. On top of the global financial crisis and the decline in key exports such as coffee, poor rains crippled the dominant agriculture sector, lack of power generation forced partial shutdown of factories, and the acute shortage of foreign exchange persisted with no end in sight. End Comment.

Tumbling Inflation Rates

¶5. (U) According to Ethiopia's Central Statistics Agency, annual year-on-year inflation sharply declined to -3.7 percent in October 2009 down from a record high of 64.2 percent in July 2008. Similarly, annual average inflation tumbled to 14.1 percent in October from a record high of 46.2 percent in February 2009. Annual

food and cereals inflation rates fell to -12.8 and -27.4 percent in October 2009, respectively, down from record highs of 91.8 and 171.9 percent in July 2008. Food items account for over half of the weight in the consumer price index, so overall inflation trends are closely tied to the seasonality of cereal production. Factors that contributed to the decline in inflation include the GoE's tightening of fiscal and monetary policy in late 2008, the importation of wheat, and a properous cereals harvest during November and December ¶2008. A recent IMF report stated that although high food price volatility and stubborn non-food price inflation are significant risks in Ethiopia, single digit inflation looks to be achievable in the current fiscal year.

¶6. (SBU) Comment: Although annual inflation rates have sharply declined in the past few months, prices are still significantly higher compared to two years ago and food prices are expected to rise again in early 2010 due to forecasted food shortages. Overall, food, and cereals inflation rates, respectively, were 55.3 percent, 61.4 percent and 103.9 percent higher when compared to two years ago. In addition, Ethiopians are increasingly feeling the pinch of rising fuel prices ever since the GoE lifted its fuel subsidy in October 2008. Gas prices hit 12.39 Birr per liter (USD 3.72 per gallon) in October 2009, up over 65 percent (in Birr terms) from just six months ago. Gas prices were 7.47 Birr per liter (USD 2.53 per gallon) in April 2009. End Comment.

Birr Still Overvalued; Forex Crunch Continues

¶7. (SBU) The Ethiopian Birr is now trading at 12.59 per USD, demonstrating a 26 percent depreciation in the past nine months. The spread between the official and parallel market rate has narrowed to 5 percent in contrast to 20 percent in 2008. The IMF believes the Birr is still overvalued and that Ethiopia faces a difficult external environment in 2009/10. The IMF's estimate on the level of Ethiopia's foreign currency (forex) reserves suggest a troubling outlook for the country's balance of payments as the global recession continues to take a toll on remittances, exports, foreign direct investment, oil prices, and official development assistance. The current level of forex reserves stands at USD 1.8

billion, up from a record low of about USD 700 million at the end of ¶2008. The IMF estimates forex reserves will shrink by USD 250 million in the coming months which will reverse one-half of the reserve rebuilding achieved in fiscal year 2008/09.

¶8. (SBU) Comment: Further depreciation of the Birr in the current fiscal year is expected, but the Birr should not devalue much beyond 14-15 Birr/USD. The narrowing spread between the official and parallel exchange rates is explained by the fact that the Birr is getting closer to a market-balanced exchange rate and the GoE's crackdown on black market traders. The lack of forex continues to constrain private sector development and the GoE's ability to handle adverse shocks to the economy. The recently approved USD 241 million Exogenous Shocks Facility (ESF) IMF loan will boost forex inflows and help reserves recover in the short term; however, the GoE needs a long-term strategy to address this critical problem. End Comment.

Widening Trade Deficit

¶9. (SBU) Ethiopia's exports totaled only 1.4 billion in fiscal year 2008/09, missing the USD 2.5 billion target by over 40 percent. Exports actually decreased slightly from the 2007/08 year of 1.5 billion. Coffee exports--Ethiopia's major export earner--were down 28 percent from last year in terms of value and coffee's share of total exports shrunk from 35 to 26 percent. The GoE blames domestic marketing problems and the decline in world commodity prices as causes for the slash in coffee export earnings. On the other hand, total imports were valued at USD 7.7 billion during 2008/09, an annual increase of 14 percent. Capital goods imported accounted for USD 2.5 billion or 32 percent of the total, followed by consumer goods of USD 2.3 billion, and fuel of USD 1.3 billion. Therefore, the trade deficit widened to USD 6.3 billion in 2008/09, in contrast to USD 5.3 billion in the preceding year. The IMF attributed the

ballooning trade and balance of payments deficits primarily to an increase in public sector spending. Despite the poor export performance in 2008/09, the GoE set an ambitious export goal of USD 2.9 billion for fiscal year 2009/10. Ethiopia has already missed the first quarter mark by 31 percent, earning only USD 343 million compared to the USD 496 million projection.

¶10. (SBU) Comment: The newly-established Ethiopia Commodity Exchange (ECX) created a variety of logistical problems for both buyers and sellers in the industry during the past year. ECX has worked hard to resolve these issues and a bumper coffee harvest is expected this year. Coffee as well as other exports, however, still faces serious risks from any global economic downturn and the threat of drought. The GoE is not only working to boost exports from a variety of sectors, but it is finally beginning to entertain discussions of import substitution as a means to reduce the trade deficit. It is not clear at this time which, if any, priority sectors for import substitution the GoE will identify. End Comment.

Power Supply Boosted By Three New Plants

¶11. (U) Three new hydroelectric power plants are set to generate over 1000 megawatts (MW) of electricity to address the chronic power shortages across Ethiopia. Tekeze Hydro Electric power plant held its inaugural ceremony on November 14 and it has a 300 MW capacity. Two other plants, Tana Beles and Gilgel Gibe II, are nearly complete and will begin generating power by March 2010.

¶12. (SBU) The chronic power outages of early 2009 abated somewhat towards the end of the rainy season in September/October, as many hydro power dams filled with water. Periodic power outages do continue though, as demand continues to outpace supply. CDA Meece and post's Regional Environmental Officer attended the November 14 onsite ceremony at Tekeze Dam in remote northern Ethiopia to highlight U.S. Company MWH's involvement in the design of the dam. CDA Meece's speech received positive press coverage highlighting U.S. involvement alongside Chinese company involvement in the

construction. The Tekeze dam is currently generating only 75 MW of its 300 MW capacity. GoE officials claim water levels are sufficient to operate the plant at full capacity, however, at full capacity the dam would run out of water before the next rainy season. GoE officials report that after the 2010 rainy season, the dam's reservoir should have sufficient levels to run at full capacity. End Comment.
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